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No. 347

In the Supreme Court of the United States

OCTOBER TERM, 1950

UNITED STATES OF AMERICA, PETITIONER

v.

ELLIS R. LEWIS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The special findings of fact and opinion of the Court of Claims (R. 4–11), together with the dissenting opinion of Judge Whitaker (R. 11–13), are reported at 91 F. Supp. 1017.

JURISDICTION

The judgment of the Court of Claims was entered on July 10, 1950 (R. 13). A petition for a writ of certiorari was filed on October 6, 1950, and was granted on December 11, 1950 (R. 14). The jurisdiction of this Court rests on 28 U. S. C., Section 1255 (1).

QUESTION PRESENTED

During the year 1944, taxpayer received from his employer compensation consisting of salary and bonus, to which at that time he made claim and believed he was entitled. However, pursuant to a court judgment in the year 1946, he was obligated to return a portion of the bonus to the employer. Was the amount thus returned to the employer properly included in taxpayer's taxable income for the year 1944?

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (*a*) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

> SEC. 41. GENERAL RULE.
>
> The net income shall be computed upon the basis of the taxpayer's annual account-

ing period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(26. U. S. C. 1946 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687.] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 42.)

STATEMENT

There is no dispute as to the relevant facts. The following is a summary of the special findings of fact made by the Court of Claims (R. 4–7):

During the entire calendar year 1944, and for some years prior thereto, taxpayer was vice-president, a member of the board of directors, and general manager of Accurate Spring Manufacturing Company (R. 5) (referred to herein as the "company"). During 1944, he was in active charge of the entire operation of the company, and, among other things, he did all the hiring and discharging, executed all the contracts, signed checks together with the individual who was the bookkeeper and assistant treasurer of the company, and directed the policies of the company. The president of the company, Frank B. Weber, was in Florida during the year 1944, and at no time during that year participated in the conduct of the business of the company except for one or two telephone conversations with taxpayer and one or two meetings with taxpayer, once in New York City and once in Ashland, North Carolina. (R. 5–6.)

Taxpayer had been selected by the president of the company in December 1938, to be its general manager effective January 1, 1939. It was then agreed between taxpayer and the president that, in addition to a stated salary, taxpayer was to receive a bonus of 10 percent of the net profits of the company before deduction for taxes. Taxpayer was paid on that basis for the years 1939 and 1940. At some time late in 1941 the president and taxpayer discussed the matter of taxpayer's bonus and the amount of compensation

which, due to the large increase in the company's profits from increased business, he would receive on the existing basis. However, it was decided that no change would be made until after the profits for 1941 had been determined. (R. 6.)

Subsequently, after the 1941 profits had been determined, and early in 1942, taxpayer was presented with a statement showing the bonuses to be paid him, based on computations of the bonus both before and after deduction for taxes. Taxpayer agreed to accept for 1941 the bonus computed after deduction for taxes, and he was paid on that basis for that year. Without further agreement between taxpayer and the president of the company, the compensation for the years 1942 and 1943 was likewise paid on the basis of the computation after deduction for taxes. (R. 6.)

For the year 1944, without further agreement between taxpayer and the company, taxpayer directed payment to himself of a bonus on the basis of a computation on profits before deduction for taxes. On this basis, the bonus paid to taxpayer was $21,924. At the time, taxpayer believed this calculation to be in accord with the agreement upon which he was entitled to have his bonus computed, notwithstanding his acceptance of the bonus for 1941, 1942, and 1943 on the basis of a computation after deduction for taxes. (R. 6.)

In its income tax return for 1944, filed in March 1945, the company deducted as a part of

the compensation paid to officers the sum of $21,924, as paid to taxpayer, and the company's tax was accordingly computed and paid. Later in 1945, the company filed an amended return, in which it deducted as bonus compensation to taxpayer the sum of $11,067.94, instead of $21,924 deducted in its original return. The additional tax based on the recomputation was paid by the company. (R. 6.)

Some time after the company's return for 1944 had been filed, taxpayer was discharged from his position with the company. Following his discharge, taxpayer brought suit against the company in the Circuit Court of Cook County, Illinois, claiming, among other things, that by reason of deductions of improper items as expense, the profits before taxes were stated too low and that a larger bonus should have been paid to him for 1944. The company filed a counterclaim, claiming, among other things, improper action on the part of taxpayer in directing payment to himself of a bonus computed on the profits before taxes, and that thereby taxpayer received as a bonus $21,924, instead of $11,067.94, which was the correct amount computed after deduction for taxes. (R. 6–7.)

At the trial in the state court, taxpayer testified that the agreement was to pay a bonus based on profits before taxes (R. 7). The state court found that the agreement for 1944 was that the bonus should be computed on the profits after

deduction for taxes, that taxpayer erroneously and mistakenly believed and understood that the bonus was to be computed before deduction of taxes, and that by virtue of this mistake taxpayer received for the year 1944 the sum of $10,856.06 in excess of the amount to which he was entitled under the agreement as found by the court. Judgment was entered for the company, on December 3, 1946 (as of November 15, 1946), in an amount which included the indicated excess of the bonus payment. (R. 7.)

Taxpayer's taxable income for 1944, as shown on his amended return for that year, filed on November 7, 1945, was $40,177.62, and this sum included the amount of $21,294 as taxpayer's bonus from the company for the year 1944, based upon a percentage of the net profits. He paid tax in the amount of $18,098.99, and $71.34 as interest for a partial late payment. (R. 7.)[1]

Excluding from his taxable income the amount of $10,856.06, which the state court decreed was improperly paid to taxpayer, and which he repaid

---

[1] Taxpayer had originally filed an income tax return for the calendar year 1944, on or shortly prior to March 15, 1945, disclosing taxable income of $37,472.30 and a tax of $16,259.37, which was timely paid. Subsequently, on November 7, 1945, he filed an amended return for 1944, showing taxable income of $40,177.62 and a total tax of $18,098.99. With the amended return, taxpayer paid $1,839.62, the balance due after allowing credit for $16,259.37 previously paid pursuant to the original 1944 return. Because of late payment of this amount of $1,839.62, the Collector assessed $71.34 as interest, which taxpayer paid on October 18, 1946. (R. 5.)

to the company in 1946, taxpayer's taxable income for 1944 would be $29,321.56, and his tax on his 1944 income would be $10,953.17—that is, $7,145.82 less than the tax which he had paid, not including $71.34 interest which he had also paid because of the late payment of the tax. (See fn. 1, *supra,* p. 7.) The sum of these two amounts is $7,217.16. (R. 7.)

On March 25, 1947, taxpayer filed with the Collector of Internal Revenue at Chicago, Illinois, a claim for refund of income taxes for the calendar year 1944, and interest and penalty on part thereof, in the aggregate amount of $7,217.16, based on the circumstances above set forth. Subsequently, on or about October 3, 1948, taxpayer received a notice from the Commissioner of Internal Revenue, dated September 28, 1948, advising him of the disallowance in full of this refund claim. (R. 7.)

Suit against the United States in the court below was filed October 29, 1948 (R. 1), and resulted in the judgment under review in favor of taxpayer in the amount claimed, namely, $7,217.16, with interest (R. 13). Judge Whitaker dissented (R. 11–13).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred:

1. In holding that taxpayer's receipt in 1944 of that part of the bonus, the equivalent of which he later refunded to his employer pursuant to an

adverse state court judgment, did not constitute taxable income for the year 1944.

2. In holding that the receipt of such sum by taxpayer under *bona fide* claim of right, and without restriction as to its disposition, even though his right to such receipt was later contested, did not constitute taxable income for the year 1944.

3. In failing to hold that the United States was entitled to retain the income tax on such receipt for 1944, in the amount of $7,217.16.

4. In holding that taxpayer is entitled to refund of such tax and to recover from the United States $7.217.16 with interest, and in granting judgment in favor of taxpayer and against the United States.

SUMMARY OF ARGUMENT

The entire sum received by taxpayer during 1944 by way of bonus, claimed by him at that time, to which he believed he was entitled, and which he unrestrictedly used, was properly included in his taxable income in that year, although subsequently, in 1946, he was obliged, pursuant to a state court judgment, to return a portion of the bonus to his employer.

A. Since the imposition of a tax upon income requires that points of time be fixed between which the income is to be measured for tax purposes, Sections 41 and 42 of the Internal Revenue Code prescribe that net income shall be computed

upon the basis of taxpayer's annual accounting period and that the amount of all items of gross income shall be included for the taxable year in which received by taxpayer. This rule of annual accounting is essential in order to "produce revenue ascertainable, and payable to the government, at regular intervals," as well as "to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation." *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365.

B. The controlling ruling in *North American Oil* v. *Burnet*, 286 U. S. 417, 424, follows as a necessary corollary. The Court there held that "if a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." The court below, however, renounces these well settled principles and would substitute for them a different system, by which the tax is assessed wholly or in part on the basis of the finally ascertained results of particular transactions. Similar efforts have been consistently repudiated by this Court over a period of more than twenty years.

C. In the years intervening since 1932, the *North American Oil* case, and the "claim of right" doctrine there enunciated, have also been

repeatedly applied in a multitude of cases by the courts of appeals of every circuit, without exception. Moreover, before deviating from it in *Greenwald* v. *United States,* 57 F. Supp. 569 (1944), the Court of Claims itself four times followed and correctly applied the principle. The courts have held earnings or gain taxable in the year of receipt (1) even though, as here, the taxpayer's right to the money is subject to dispute, and liability to restore its equivalent may be, or is being, asserted, or (2) even though the income is subject to an obligation to restore which is admitted or uncontroverted, but, at the same time, contingent or indefinite. It has made no difference in result, moreover, that the taxpayer has been required to repay the equivalent in a subsequent year, as was the present taxpayer, nor that he voluntarily paid the tax on the original receipt, and after making the repayment sought a tax refund. For the corollary of the *North American* rule is that, in the event of repayment, taxpayer is allowed a deduction from the profits of the refund year.

D. There is no reason or occasion for the Court to change these settled rules. The "claim of right" doctrine has achieved an established status which should be changed, if at all, only by Congress, and there is nothing in the present legislation indicating that Congress has such a purpose or desire. Under the sweeping language of Section 22 (a) of the Internal Revenue Code, Congress intends to include in gross income everything which in

fact is income derived from any source whatever, and the provisions for annual accounting show that each taxable year is to be considered as a unit. Wherever it has desired to make exceptions to these rules, Congress has done so in express and carefully limited terms. The issue here is, essentially, in which year shall the balancing deduction be taken—the year of receipt or the year of refund. This is a subject for legislative choice, and Congress has thus far chosen the former.

Moreover, there are good reasons for retaining the "claim of right" doctrine. The Government should be able to exact prompt collection of taxes without being compelled to take sides in, or await the outcome of, private controversies. The taxpayer has unrestricted use of the gain, can pay the tax out of its proceeds, and is treated on a par with other taxpayers receiving income in that year. In addition, since the issue whether a particular item is includible in taxable income of the year of receipt cannot turn on the taxpayer's choice to pay the tax and then seek a refund or to await a deficiency assessment, the decision below tends to foster delay in payment and speculation on the part of the irresponsible and unscrupulous at the expense of the Government and the general body of law-abiding taxpayers; and it does so with respect to taxes on profits which, by hypothesis, the taxpayer unrestrictedly uses throughout and claims as rightfully his.

Eventual collection of the tax is also imperiled, since in the subsequent year of settlement of the controversy taxpayer may no longer be in possession of the means with which to satisfy the tax.

Other difficulties would also ensue if the decision below were allowed to stand. On the theory of the court below, in a case where taxpayer had not repaid the income until after expiration of the time limitation for filing refund claims, he would be remediless, since the ground of the holding is that the original receipt of money is not to be regarded as income in the taxable year, and therefore tax effect could be given to the repayment only in that barred year. Similarly, a taxpayer might support a claim for tax refund, even though, for example, he had never satisfied a state court judgment compelling repayment, on the theory that the order for repayment automatically transformed the gain previously received into non-income. These awkward and discriminatory consequences necessarily flow from the premises of the Court of Claims opinion. They cannot properly be cured by some such device as allowing the taxpayer the option of seeking a readjustment in the year of original receipt or of claiming a deduction in the year of repayment. That hybrid rule would discriminate against the revenue by permitting the taxpayer to select the most advantageous tax treat-

ment, and give the Government no compensating advantage. In any event, such a novel rule may not appropriately be made by the courts, but would require legislative intervention.

On the other hand, the annual system of computation, which Congress has elected and to which it has consistently adhered since the inception of the income tax, affords equity in general and, by virtue of the deduction allowed in the repayment year, works no particular injustice in this class of case. The uniform result of the established system has been denial both to the Government and to taxpayers of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment. The difficulties implicit in the decision below demonstrate the fairness and practicality of the present rule, as well as the intrinsic legislative character of any change, such as that attempted by the court below.

ARGUMENT

THE ENTIRE SUM RECEIVED BY TAXPAYER DURING 1944 BY WAY OF SALARY AND BONUS, CLAIMED BY HIM AT THAT TIME AND TO WHICH HE BELIEVED HE WAS ENTITLED, WAS PROPERLY INCLUDED IN HIS TAXABLE INCOME IN THAT YEAR, ALTHOUGH IN 1946 HE WAS OBLIGED, PURSUANT TO A STATE COURT JUDGMENT, TO RETURN A PORTION OF THE BONUS TO HIS EMPLOYER

The entire bonus in controversy was received by taxpayer in 1944, received under claim and *bona fide* belief that it was his, as of right (R. 6). He gained title to, and unrestricted use of, the

money in that year, and claimed and treated it as his own. Indeed, in the succeeding year (1945), he insisted that he was entitled to an even larger amount from his former employer for 1944 bonus, and instituted suit in an Illinois court in enforcement of this claim. In that suit, the company counterclaimed that the bonus paid to taxpayer in 1944 was excessive (R. 6–7, 8–9). But, at the trial, taxpayer continued to maintain and, indeed, swore, that he was entitled to the entire amount paid him in 1944 (R. 7, 12). Only when forced by the adverse judgment of the state court, did taxpayer in 1946—two years after its receipt—pay to the company the sum of $10,856, representing the equivalent of that part of the bonus found by the state court to be excessive (R. 7, 9, 12–13). These are the undisputed facts upon which it must be determined whether or not the bonus constituted income to taxpayer in 1944.

A. Since income is by nature a flow, rather than a static condition or object, the imposition of a tax upon income requires that points of time be fixed between which the income is to be measured for tax purposes. Hence, as this Court said, in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363:

> All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period,

> either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.

Thus, Section 41 of the Internal Revenue Code, *supra*, pp. 2–3, prescribes that "The net income shall be computed upon the basis of the taxpayer's *annual* accounting period" [italics supplied], and Section 42, *supra* (p. 3), entitled "Period In Which Items Of Gross Income Included", requires that "The amount of all items of gross income shall be included in the gross income *for the taxable year in which received* by the taxpayer" [italics supplied].

Indeed, as this Court further explained in the *Sanford & Brooks* case, a rule of annual accounting is requisite, as a general matter, both to assure the Government regular and ascertainable production of revenue and a system susceptible of practicable operation (p. 365):

> The Sixteenth Amendment was adopted to enable the government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation.

If, instead of this system of annual accounting, a basis of finally ascertained results of particular transactions is to be substituted, Congress and not

the courts must provide it. *Burnet* v. *Sanford & Brooks Co., supra*, at 387.

This general principle of annual accounting has been consistently applied by this Court, absent a specific statutory provision to the contrary, to a number of varying circumstances. *E. g. Lucas* v. *Ox Fibre Brush Co.*, 281 U. S. 115, 120 (corporation may deduct bonuses paid to officers in taxable year though services were largely rendered in previous years); *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 306 (taxpayer cannot deduct from income for taxable year "depreciation, depletion, business losses or other similar items attributable to other years"); *Woolford Realty Co.* v. *Rose*, 286 U. S. 318, 326 (no deduction of losses suffered in earlier years); *Brown* v. *Helvering*, 291 U. S. 193 (contingent liability not actually incurred in taxable year may not be deducted as expense paid or incurred); *Guaranty Trust Co.* v. *Commissioner*, 303 U. S. 493, 498 (decedent partner's estate taxable on all income received during taxable year, including that earned after end of partnership's fiscal year, and not simply on income earned during partnership's year).

B. This Court's ruling in *North American Oil* v. *Burnet*, 286 U. S. 417, announcing the "claim of right" doctrine which is controlling here, is another corollary of the general principles expounded in the *Sanford & Brooks* case. In the *North American* case, the Court held income tax-

able in the year of receipt (1917), even though the litigation on which the right to the money depended was still in process and was not decided until 1922. In oft-followed language, Mr. Justice Brandeis said for the Court (p. 424):

> The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. See *Board* v. *Commissioner*, 51 F. 2d 73, 75, 76. Compare *United States* v. *S. S. White Dental Mfg. Co.*, 274 U. S. 398, 403. If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year. Compare *Lucas* v. *American Code Co., supra.*

Contrary to the statement of the majority of the Court of Claims in the opinion below (R. 9), and in *Gargaro* v. *United States*, 73 F. Supp. 973, 975, this expression of the Court was neces-

sary to its decision and was not dictum. The question posed and decided was whether the profits were income in 1917, the year of receipt under claim of right, even though subject to an outstanding contingent liability which might entail future restoration of the equivalent, or whether the profits were income in 1922, the year in which the outstanding adverse claim against the earning was finally disposed of by conclusion of the litigation in taxpayer's favor. The holding was that the contingent liability to refund did not affect its quality as income in the earlier year of receipt. See *Brown* v. *Helvering,* 291 U. S. 193, 199, *infra.* Thus, whether, in fact, the money was or was not later refunded was irrelevant to the issue presented and decided.

Moreover, in succeeding decisions, the Court has afforded repeated confirmation to the principle of the *North American* case. Thus, the quality of a receipt, as income, is not affected by the circumstance that part may have to be refunded in some future year, in the event a contingent obligation, subject to which the payment was received, becomes absolute. So this Court, referring to the *North American Oil case,* held in *Brown* v. *Helvering,* 291 U. S. 193, 199:

> When received, the * * * right to it was absolute. It was under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

Nor is it of any significance that until completion it cannot be known whether a business venture as a whole has been profitable, for (*Heiner* v. *Mellon,* 304 U. S. 271, 275)—

> Under that law [the Federal income tax system] the question whether taxable profits have been made is determined annually by the result of the operations of the year

and "the tax on a year's income may not be withheld because losses may thereafter occur" (p. 276).

In *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, the receipt by taxpayer of a processing tax, as part of the sales price of goods sold, was held to constitute income in the year of receipt, even though the validity of the tax was then in dispute, and the tax was refunded by taxpayer to the purchasers in later years (p. 284). Quoting from and following *Burnet* v. *Sanford & Brooks Co., supra,* as expressing a "legal principle * * * often * * * stated and applied," (p. 286), the Court rejected taxpayer's contention, which would have (pp. 285–286)—

> upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is

> neither a cash basis nor an accrual basis, because so to do would, in a given instance work a supposedly more equitable result to the Government or to the taxpayer.

Commissioner v. *Wilcox*, 327 U. S. 404, provides further proof of this Court's acceptance of the "claim of right" doctrine, for there, referring to the *North American Oil* case, *supra*, the Court said (p. 408):

> For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of § 22 (a).

The *Wilcox* case, however, involved the tax liability of an embezzler, and in determining that the amount embezzled was not income for tax purposes, this Court stressed the fact that the embezzler had (p. 408)—

> received the money without any semblance of a bona fide claim of right. And he was at all times under an unqualified duty and obligation to repay the money to his employer.

Wilcox did not overrule or modify the rule of the *North American* case, and reliance upon it by the Court of Claims here (R. 9–10), and in its prior decision, *Gargaro* v. *United States*, 73 F. Supp. 973, 975, is erroneous. In the present case, in contrast to *Wilcox*, the money was received under claim of right, concededly *bona fide*, asserted and continuously maintained by taxpayer under the most solemn circumstances for two years. His obligation to repay was not definite, unconditional or unqualified, but, on the contrary, was disputed and settled only after litigation. His receipt of the money bore no resemblance to a loan, and at the time of receipt and for some time thereafter he had undisputed title and unrestricted use of the money as his own.

Here, as in *St. Regis Paper Co.* v. *Higgins*, 157 F. 2d 884 (C. A. 2d), certiorari denied, 330 U. S. 843, the payment (p. 885)—

> violated no law and at most * * * was the breach of a private contract and the recipient was not without all semblance of right and title to them as was the embezzler in *Commissioner* v. *Wilcox* * * *.

The five additional Courts of Appeals, which have had occasion to pass upon the question, have similarly understood the *Wilcox* case.[2] *Fleischer*

[2] In accord, also, are the dissenting opinions of Judge Whitaker, below (R. 12), and in *Gargaro* v. *United States*, 73 F. Supp. 973, 976 (C. Cls.).

v. *Commissioner,* 158 F. 2d 42, 43–44 (C. A. 8th); *Greenfeld* v. *Commissioner,* 165 F. 2d 318, 320 (C. A. 4th); *Currier* v. *United States,* 166 F. 2d 346, 348 (C. A. 1st); *Akers* v. *Scofield,* 167 F. 2d 718 (C. A. 5th), certiorari denied, 335 U. S. 823; *Haberkorn* v. *United States,* 173 F. 2d 587, 590 (C. A. 6th), where it was aptly said:

> The *Wilcox* opinion does not purport to overrule the established principle applied in *North American Oil Consolidated* v. *Burnet.* It was decided upon the particular facts involved, which in the Court's opinion made the usual rule inapplicable.

Nor, contrary to the majority opinion below (R. 10–11), was the scope of the *North American Oil* case limited by *Freuler* v. *Helvering,* 291 U. S. 35. The latter case turned upon the language of a statute (Section 219 of the Revenue Act of 1921) specially providing for division of the tax burden as between an estate and its beneficiaries, by directing taxability to a beneficiary to depend not on the amount of income actually paid to him, but on that payable or "distributable" (pp. 37, 42). Indeed, both cases were decided within two years and by the identical Court, which, in the *Freuler* case, expressly distinguished the *North American Oil* case (there cited by the Commissioner) on the ground that in the *North American Oil* case (p. 43): "Section 219 had no bearing upon the question presented." So, also, with reference to the *North American Oil* case, the

Second Circuit, in *General Outdoor Advertising Co.* v. *Helvering*, 89 F. 2d 882, 883, held—

> we do not consider its scope limited by *Freuler* v. *Helvering*, 291 U. S. 35, 54 S. Ct. 308, 78 L. Ed. 634, which turned upon the language of the section taxing the beneficiaries of a trust.

The *Freuler* case is simply an example of an express statutory exception to the general principle of annual accounting.

C. In the years intervening since its decision in 1932, the *North American Oil* case, *supra*, and the "claim of right" doctrine there enunciated, have repeatedly been followed and applied in a multitude of cases in the lower federal courts of all circuits, without exception, and in the Tax Court.[3] Moreover, the Court of Claims, prior to its decision in 1944 in *Greenwald* v. *United States*, 57 F. Supp. 569, four times followed and correctly applied the "claim of right" principle, as

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[3] See, for example, the following representative decisions by the court of appeals in each of the several circuits: *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473 (C. A. 1st); *St. Regis Paper Co.* v. *Higgins*, 157 F. 2d 884 (C. A. 2d); *Clay Sewer Pipe Ass'n* v. *Commissioner*, 139 F. 2d 130 (C. A. 3d); *Anderson* v. *Bowers*, 170 F. 2d 676 (C. A. 4th), certiorari denied, 337 U. S. 918; *Akers* v. *Scofield*, 167 F. 2d 718 (C. A. 5th); *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th); *Griffin* v. *Smith*, 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561; *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th); *Commissioner* v. *Alamitos Land Co.*, 112 F. 2d 648 (C. A. 9th), certiorari denied, 311 U. S. 679; *Saunders* v. *Commissioner*, 101 F. 2d 407 (C. A. 10th); *Barker* v. *Magruder*, 95 F. 2d 122 (C. A. D. C.).

established by this Court in the *North American Oil* case: *McDuffie* v. *United States*, 19 F. Supp. 239, 246–247 (1937); *Thomas* v. *United States*, 22 F. Supp. 412, 415 (1938); *Schramm* v. *United States*, 36 F. Supp. 1021 (1941); *Agne* v. *United States*, 42 F. Supp. 66, 72–73 (1941).[4] Only with the *Greenwald* case, *supra*; *Gargaro* v. *United States*, 73 F. Supp. 973, *supra* (on demurrer, 1947), and 86 F. Supp. 840 (on the merits, 1949);[5] and the decision below, did the Court of Claims deviate from the rule established by this Court in the *North American Oil* case, and "the great weight of authority," *Haberkorn* v. *United States*, 173 F. 2d 587, 590 (C. A. 6th), and attempt to substitute a system based on finally-ascertained results of particular transactions.

1. The doctrine has been applied by the lower courts in a variety of situations: (a) In one class of cases, the earning or gain has been held taxable in the year of receipt, even though, as here, the taxpayer's right to the money is subject to dispute, and liability to restore its equivalent may be, or is being, asserted: *Board* v. *Commissioner*, 51 F. 2d 73 (C. A. 6th), certiorari denied, 284 U. S. 658 (director's profit on contract with corporation; right to retain contested by stockholders' cited by this Court in the *North American Oil* case, p. 424; *McDuffie* v. *United States*,

[4] *Wells* v. *United States*, 64 F. Supp. 476, 479–480 (C. Cls.) (1946), represents no departure in principle since the payment there was found, as a matter of fact, to be an advance or loan and not compensation received under claim of right.

[5] In the *Gargaro* case, as here, Judge Whitaker dissented.

19 F. Supp. 239 (C. Cls.), pp. 245–247 (money received by lessee from oil leases, subsequently cancelled for fraud and money judgment obtained by the United States for all sums received); *Thomas* v. *United States,* 22 F. Supp. 412, 415 (C. Cls.) (compensation received for securing contracts, claimed to have been paid under mistake); *National City Bank of New York* v. *Helvering,* 98 F. 2d 93 (C. A. 2d) (director held out part of profits on illegal oil lease, repaid to corporation during Senate investigation); *Griffin* v. *Smith,* 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561 (corporate officer and director paid himself excessive bonuses, refunded on demand of stockholders); *Saunders* v. *Commissioner,* 101 F. 2d 407 (C. A. 10th) (officer's commission on sale of stock, restored on demand); *Commissioner* v. *Alamitos Land Co.,* 112 F. 2d 648 (C. A. 9th) (sum received in payment of judgment of lower state court, later repaid upon reversal by state supreme court); *Penn* v. *Robertson,* 115 F. 2d 167, 173–174 (C. A. 4th) (money received under a stock purchase plan, invalid under state law, rescinded in a subsequent year and gain repaid); *Schramm* v. *United States,* 36 F. Supp. 1021 (C. Cls.) (gain derived from liquidating dividend, subsequently returned to satisfy an additional federal tax assessment on corporation); *Agne* v. *United States,* 42 F. Supp. 66, 72–73 (C. Cls.) (proceeds from sale of stock taxable in year of receipt, although right to their

retention successfully disputed by minority stockholders and later partially repaid); *Moore* v. *Thomas,* 131 F. 2d 611 (C. A. 5th) (money received by underwriting agency, subject to repayment by reason of breach of contract to maintain premium reserve); *St. Regis Paper Co.* v. *Higgins,* 157 F. 2d 884 (C. A. 2d), certiorari denied, 330 U. S. 843 (dividends distributed to stockholders allegedly in violation of declaring corporation's contract, later repaid); *Fleischer* v. *Commissioner,* 158 F. 2d 42 (C. A. 8th) (salaries later repaid to employer corporation, after having been disallowed by federal tax authorities); *Commissioner* v. *Switlik,* 184 F. 2d 299 (C. A. 3d) (gain derived from liquidating dividend, subsequently returned to satisfy an additional federal tax assessment on corporation); *Downing* v. *Commissioner,* 43 B. T. A. 1147 (sum retained by broker out of sales price, partially repaid after dispute and litigation with his principal).

(b) Other cases have held the tax properly collected in the year of receipt, even though the income is subject to an obligation to restore, which is admitted or uncontroverted, but, at the same time, contingent or indefinite: *Chi. R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. 2d 990 (C. A. 7th), certiorari denied, 284 U. S. 618 (overcharges by railroad through mistakes in computation of fares by station agents, the names of the passengers to whom the excess amounts were due being unknown), decided before the *North American Oil*

case; *Blum* v. *Helvering*, 74 F. 2d 482 (C. A. D. C.), certiorari denied, 295 U. S. 732 (profits realized from stock sales, subject to the obligation to support market with a fund in a stated minimum amount by operating a trading pool for six months subsequent); *Fairmount Creamery Corp.* v. *Helvering*, 89 F. 2d 810 (C. A. D. C.) (interest received by corporation from employees to whom stock had been sold on credit, subject to refund in the event employee quit or was discharged); *Barker* v. *Magruder*, 95 F. 2d 122 (C. A. D. C.) (usurious interest, recoverable in the event borrower made claim); *Commissioner* v. *Lyon*, 97 F. 2d 70, 73–74 (C. A. 9th) (cash paid to lessor at beginning of ten-year term, subject to refund on termination of lease otherwise than by default of lessee); *First Nat. Bank* v. *Commissioner*, 107 F. 2d 141 (C. A. 6th) (proceeds of a note held taxable, notwithstanding contingent liability to repay at maturity if maker failed or if purchase of certain corporate assets was not consummated); *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473 (C. A. 1st) (unclaimed deposits and refunds due former customers of gas company); *Detroit Consolidated Theatres* v. *Commissioner*, 133 F. 2d 200 (C. A. 6th) (sum received as advance rental deposit); *Caldwell* v. *Commissioner*, 135 F. 2d 488 (C. A. 5th) ("kickbacks" to state building superintendent paid by contractors, although possibly recoverable by state); *Jacobs* v. *Hoey*, 136 F. 2d 954 (C. A. 2d),

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certiorari denied, 320 U. S. 790 (irregular advance by estate to executor on account of commissions, before allowance by court); *Clay Sewer Pipe Ass'n* v. *Commissioner,* 139 F. 2d 130 (C. A. 3d) (prepayment for services to be rendered, although under contract recipient may be liable subsequently to return their equivalent); *DeGuire* v. *Higgins,* 159 F. 2d 921 (C. A. 2d) (dividends payable to purchaser of stock subject to possible refund under contract terms); *Akers* v. *Scofield,* 167 F. 2d 718 (C. A. 5th), certiorari denied, 335 U. S. 823 (money received in reliance upon fraudulent representation, subject to recovery in the event of avoidance by defrauded party); *Anderson* v. *Bowers,* 170 F. 2d 676 (C. A. 4th), certiorari denied, 337 U. S. 918 (executor's commissions calculated upon an erroneous basis, subject to refund in the event proper action brought); *Capital Warehouse Co.* v. *Commissioner,* 171 F. 2d 395 (C. A. 8th) (prepayment for services, whose cost taxpayer must defray in later year); *Haberkorn* v. *United States,* 173 F. 2d 587 (C. A. 6th) (bonus subsequently returned to employer because of error in calculation of profits, upon which the bonus was based); *Gilken Corp.* v. *Commissioner,* 176 F. 2d 141, 144–145 (C. A. 6th) (sum received as advance rental deposit).

In each of these cases, as in the instant case, there were present, at the time of receipt, a *bona fide* claim of right to the alleged gain, title to it,

and unrestricted freedom in disposition, and there was absent a definite, unqualified and unconditional obligation to repay or return its equivalent.[6]

2. It makes no difference, of course, that taxpayer was actually required, by the 1946 Illinois

[6] In his brief in opposition to certiorari (p. 7), taxpayer cites *Commissioner* v. *Turney*, 82 F. 2d 661 (C. A. 5th), and *Knight Newspapers* v. *Commissioner*, 143 F. 2d 1007 (C. A. 6th). However, these cases do not represent departures in principle from the holding in the *North American Oil* case, or the other authorities cited above. In the *Turney* case, the court held that the money was received by taxpayer as agent for another, and, hence, the duty to pay the tax was not upon him. Again, *Knight Newspapers* was expressly explained, by the court which decided it, in its subsequent *Haberkorn* case, 173 F. 2d, at p. 590, as not representing a change in "the general rule", but as presenting a factual situation under which the disputed income had never been received by the taxpayer, no claim of right ever asserted, and no economic gain resulted to the taxpayer, who, from the combination of these facts, was regarded as holding it under a constructive trust. On the *Knight* case, see also *St. Regis Paper Co.* v. *Higgins*, *supra*, 157 F. 2d, at p. 885.

Ford v. *Nauts*, 25 F. 2d 1015 (N. D. Ohio), also cited in the brief in opposition (p. 7), was in effect repudiated by the court of appeals in the circuit of its origin in *Ford* v. *Commissioner*, 51 F. 2d 206 (C. A. 6th). Both cases antedated the *North American Oil* case, with which, however, the decision of the court of appeals accords. The holding in an additional District Court case also cited in the brief in opposition (p. 7), *Buder* v. *United States* (E. D. Mo.), decided May 17, 1940, 27 A. F. T. R. 993, judgment amended, April 8, 1941, 29 A. F. T. R. 1379, appeal dismissed, 116 F. 2d 284 (C. A. 8th), is not clear and surely carries little persuasive weight in view of the many later decisions of the court of appeals of the Eighth and other circuits cited above: *e. g.*, see *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th), and *Capital Warehouse Co.* v. *Commissioner*, 171 F. 2d 395 (C. A. 8th).

judgment, to repay the bonus in that year. The courts have repeatedly held receipts in an earlier year taxable then as income, notwithstanding the fact that the taxpayer was actually required to refund them in a subsequent year. *Security Mills Co.* v. *Commissioner*, 321 U. S. 281, 284; *National City Bank of New York* v. *Helvering*, 98 F. 2d 93 (C. A. 2d); *Griffin* v. *Smith*, 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561; *Saunders* v. *Commissioner*, 101 F. 2d 407 (C. A. 10th); *Commissioner* v. *Alamitos Land Co.*, 112 F. 2d 648 (C. A. 9th); *Penn* v. *Robertson*, 115 F. 2d 167 (C. A. 4th); *Schramm* v. *United States*, 36 F. Supp. 1021 (C. Cls.); *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th); *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th); *Commissioner* v. *Switlik*, 184 F. 2d 299 (C. A. 3d); *Downing* v. *Commissioner*, 43 B. T. A. 1147 (all discussed *supra*, pp. 25–29). Taxpayer's contingent liability to his employer (in 1944) did not differ from his other debts, which might ripen and be paid in future years.

In this connection, it may also be noted that, while in our view *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th), *supra*, was rightly decided, and the decision of the Court of Claims in *Greenwald* v. *United States*, 57 F. Supp. 569, *supra*, was incorrect, and against the great weight of authority, the instant case is distinguishable from both in that taxpayer here did not recognize, but

on the contrary disputed, the obligation to repay when it was called to his attention. Although the Illinois court eventually held that taxpayer erroneously and mistakenly believed the terms of his employment contract to be different from the agreement as found (R. 7), the instant record presents not a case of mutual mistake, as erroneously ruled by the court below (R. 10), but of breach of contract. Certainly, it is not pertinent to the present problem that in any litigation one party or the other, or both, may be said to have been mistaken on the facts or law. Again, while taxpayer, as an officer of the company, directed payment to himself of the bonus (R. 6), mutual mistake no more arises in such a situation than when, by direction of a lower court, a third party pays a taxpayer a judgment, which later is reversed on appeal and the payment refunded. *North American Oil* v. *Burnet*, 286 U. S. 417, 424, *supra; Commissioner* v. *Alamitos Land Co.*, 112 F. 2d 648 (C. A. 9th), *supra.*

3. Nor has it made any difference that the taxpayer paid the tax, and later sought to obtain a refund. There is not the slightest intimation in any of the decisions applying the "claim of right" doctrine that anything turns on whether the taxpayer voluntarily paid the tax or the Commissioner assessed a deficiency, and, like the present suit, many of the cases have arisen after payment. See *Griffin* v. *Smith*, 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561;

Saunders v. *Commissioner*, 101 F. 2d 407, 408 (C. A. 10th); *Penn* v. *Robertson*, 115 F. 2d 167 (C. A. 4th); *Moore* v. *Thomas*, 131 F. 2d 611 (C. A. 5th); *St. Regis Paper Co.* v. *Higgins*, 157 F. 2d 884 (C. A. 2d), certiorari denied, 330 U. S. 843; *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th); *Jacobs* v. *Hoey*, 136 F. 2d 954 (C. A. 2d), certiorari denied, 320 U. S. 790; *Anderson* v. *Bowers*, 170 F. 2d 676 (C. A. 4th), certiorari denied, 337 U. S. 918; *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th); and the Court of Claims' previous decisions in the *McDuffie*, *Thomas*, *Schramm*, and *Agne* cases, cited *supra*, pp. 25–27.

4. As a consequence of this Court's holding in the *North American Oil* case, and as anticipated in its opinion, where a taxpayer has been obliged to refund the profits received and taxed in the earlier year, he has been allowed a deduction from the profits of the year of refund—not from those of the earlier year. *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473, 475 (C. A. 1st); *Commissioner* v. *Switlik*, 184 F. 299 (C. A. 3d); *O'Meara* v. *Commissioner*, 8 T. C. 622, 633–634; see also expressions in *Barker* v. *Magruder*, 95 F. 2d 122, 124 (C. A. D. C.); *Caldwell* v. *Commissioner*, 135 F. 2d 488, 491 (C. A. 5th); *Anderson* v. *Bowers*, 170 F. 2d 676, 679 (C. A. 4th), certiorari denied, 337 U. S. 918. The administrative practice is in accord. G. C. M. 16730, XV–1 Cum. Bull. 179 (1936), issued following the *North American Oil* decision.

The correct rule was only recently aptly summarized by the Court of Appeals for the Fourth Circuit in *Anderson* v. *Bowers*, 170 F. 2d 676, when, referring to the *North American Oil* case and other decisions above cited, it said (p. 679):

> From these decisions it is clear that when income has been received by the taxpayer or credited to him under a claim of right, it must be accounted for in the year in which it was received or could have been received by him; and if it is shown in a subsequent year that the payment was wrongfully made and the taxpayer is required to make restitution, his remedy is not to sue the Collector to recover the excess tax mistakenly paid but to claim the repayment as a deduction from income in a year in which it is made. This procedure is required because income taxes are imposed and must be accounted for on a yearly basis under the decision of *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365, 51 S. Ct. 150, 75 L. Ed. 383.

D. 1. There is no reason or occasion for the Court to change these settled rules. The mass of cases in the lower courts—with the single significant exception of the Court of Claims, in very recent years—is proof in itself that the "claim of right" doctrine has achieved an established status which should be changed, if it is to be changed, only by Congress. And Congress has given not even a hint that the *North American* rule should

be abandoned. It has continued in effect the sweeping language of Section 22 (a) of the Internal Revenue Code, *supra*, p. 2, under which it intends to "include in gross income everything which in fact is 'income derived from any source whatever.'" *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474, 475 (C. A. 2), certiorari denied, 338 U. S. 816. See also *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 223; *Helvering* v. *Clifford*, 309 U. S. 331, 334. The provisions for annual accounting also remain in the statute, as they have since the beginning of federal income taxation under the Sixteenth Amendment, and the carefully limited exceptions which Congress has provided in special cases confirm its purpose that the well-understood and consistently applied rules stemming from the annual accounting system shall continue to prevail, unless express statutory direction for the benefit of the Government or the taxpayer is made to the contrary.[7] If it be thought that fair-

[7] Examples of such special legislation are as follows: Internal Revenue Code, Section 43: in cases of fixed liabilities payable in fixed installments over a series of years, deductions are allowed in a year other than that in which actually paid, as explained in *Security Mills Co.* v. *Commissioner*, 321 U. S. 281: Section 44: installment basis income: Section 122: net operating loss deduction: Section 127: war losses: Section 128: recovery of unconstitutional federal taxes: Section 162 (b): cognate of Section 219 of Revenue Act of 1921, construed in *Freuler* v. *Helvering*, 291 U. S. 35, discussed at pp. 23–24, *supra*: Section 3806: mitigation of effect of renegotiation of war contracts or disallowance of reimbursement.

ness requires another exception in the present class of case, the remedy lies in Congress and not in the courts. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 367; *Boehm* v. *Commissioner*, 326 U. S. 287, 295. The legislature alone possesses the information and authority to weigh the general necessity of obtaining revenue promptly, as well as the significance of the additional burden imposed upon the tax administration, against the alleged hardship of these special cases.

2. There are, moreover, good reasons why the *North American* rule should be retained. If, as is the general principle, a taxpayer may not postpone to a subsequent year payment of a tax then due in order to ascertain whether the final outcome of the particular transaction ultimately results in gain or loss, the Government should be able to exact collection, in cases such as this, "without being compelled to take sides in private controversies." *National City Bank of New York* v. *Helvering*, 98 F. 2d 93, 96 (C. A. 2d), *supra*. As Judge Learned Hand there said, it would be "intolerable" to require the tax to be assessed against both parties to the dispute (p. 96)—

> * * * collection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant. If he holds with claim of right, he should be taxable as an owner, regardless of any

> infirmity of his title; no other doctrine is practically possible, and no injustice can result.

This reasoning applies, with even greater force to a case, such as this, where there is no actual dispute at the time the return is filed and the tax is paid.

With the income received under claim of right, the taxpayer is in a position to pay the tax, and he is on a par with other taxpayers who have to pay taxes on similar amounts of income in that taxable year. If he is forced to repay the money in a later year, his tax interests are sufficiently protected by the rule that he may then claim a deduction. See *supra*, pp. 33–34; *infra*, p. 41. Meanwhile, he has the unrestricted use of the money, in exactly the same way that earnings are normally available for disposition by a taxpayer.

Though the Court of Claims seems to stress the fact that the taxpayer in this case voluntarily reported the bonus in 1944 and paid the tax thereon (R. 9, 11), we do not read the opinion as laying down the novel rule that the "claim of right" doctrine should be inapplicable where the taxpayer first pays the tax and then seeks a refund. In any event, such a suggestion must be rejected, for the issue in these cases is whether an item of earnings constitutes taxable income for the year of receipt, and that issue must turn on the tax statutes and the judicially

applied concepts of taxable income, and not on the taxpayer's choice in paying, or not paying, the tax. On the question of whether the item is properly includible in taxable income, there should be no difference in result between a proceeding before the Tax Court challenging a deficiency determination and a suit for a refund in the Court of Claims or a district court.

For this reason, the result reached below inevitably encourages failure to return allegedly disputed gains in the year earned, and tends to foster speculation on the part of the irresponsible and unscrupulous at the expense of the Government and the general body of law-abiding taxpayers. The tendency will be to postpone reporting the real or allegedly disputed income until the controversy is settled. Moreover, such speculation will proceed and the tax payment be postponed in connection with profits which, by hypothesis, the taxpayer continues unrestrictedly to use, and claims as rightfully his. This Court, in *Manning* v. *Seeley Tube & Box Co.*, [illegible] S. 561, 568, disapproved a contention leading to like untoward results.

Even eventual collection of the tax is imperiled, if postponed to await settlement of the controversy in the taxpayer's favor, since in the subsequent settlement year taxpayer may no longer possess the means to satisfy the tax on the profit, which in the meantime he has enjoyed and possibly expended.

In general, then, the result reached in the court below runs counter to the principle of prompt collection of the revenue (*Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 566, *et seq.*), and ignores "the basic necessity of the Government to collect a carefully estimated sum of money by a particular date in order to meet its anticipated expenditures." *Rodgers* v. *United States*, 332 U. S. 371, 374.

Another difficulty arising out of rejection of the "annual accounting" system revolves around the statute of limitations. The Illinois court might not have settled the controversy between taxpayer and his employer until after the expiration of the period for filing refund claims. Internal Revenue Code, Section 322 (b) (in general, three years from date of filing return or two years from date of payment of tax). If the annual accounting basis applies, as we urge, the passage of the limitations period would not affect his right to a deduction in the year in which he paid the judgment. However, if the subsequent development determined that the receipt of the bonus in 1944 was never taxable, as seems to be the holding below (R. 11), the expiration of the refund period would appear to leave the taxpayer without any relief. Similarly, if no income is regarded as having been received in the earlier year, a taxpayer might support a claim for tax refund, even though he had never satisfied a judgment which his employer had obtained against him.

These problems necessarily arise if one holds, as does the court below, that the bonus did not "in fact" constitute income to the taxpayer in the year of receipt, and "he did not have the income" in that year, although he actually received it at that time (R. 11). For if an item of earnings is considered not to be income in the year of receipt, no tax need be paid on it, and if a tax is nevertheless paid on such an item, it may be recovered by refund claim during the limitations period, but thereafter there is no remedy. Nor would it be proper to attempt to avoid these difficulties by giving the taxpayer the option either to claim the original payment as non-income in the year of receipt or to treat the repayment as a deduction in a later year. Aside from the theoretical obstacles, such a choice would enable the taxpayer to select the most advantageous tax treatment and, by the same token, would discriminate against the Government, which would not have a similar option. And even if the loss-deduction treatment is limited to cases in which the statute of limitations has run, there is the double objection that a substantial unwarranted exception is made in the coverage of that statute, to the Government's detriment, and that taxpayers will be treated differently depending upon the length of time it takes to settle the underlying private controversy. In any case, adoption of these rules would require legislative intervention, and may not appropriately be made by the courts.

On the other hand, allowance of a deduction in the year taxpayer repays sums previously returned as income (see pp. 33–34, *supra*), conforms with the principle of annual accounting and creates no great injustice for the taxpayer or the Government. True, in a particular instance, as where the later year is a loss year, some hardship may result.[8] However, in other cases, the rule will redound to taxpayer's benefit, as, for example, where the tax rates in the later year are higher than those of the earlier year, or where no tax was due in the earlier year, by reason of a net loss. *O'Meara* v. *Commissioner*, 8 T. C. 622, 632–634. The system of annual periods of computation, which Congress has elected and to which it has consistently adhered since the inception of the income tax—as contrasted with a basis of finally ascertained results of particular transactions—affords equity in general and works no particular injustice in the present class of case. See also discussion, pp. 15–17, 34–37, *supra*. The many difficulties implicit in the decision below (*supra*, pp. 36–40) demonstrate the general fairness and practicality of the present rule, as well as the intrinsic legislative character of any change which could be adopted.

[8] Such hardship is alleviated by the net operating loss carry-back provisions (Internal Revenue Code, Section 122), creating an express exception to the annual accounting system and authorizing the total net operating loss for one year to be added to deductions of a preceding year. See *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 566.

CONCLUSION

The decision of the Court of Claims should be reversed.

Respectfully submitted.

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